

VZCZCXRO7519
RR RUEHAG RUEHDF RUEHIK RUEHLZ RUEHROV
DE RUEHFT #5173/01 3411025
ZNR UUUUU ZZH
R 071025Z DEC 07
FM AMCONSUL FRANKFURT
TO RUEHC/SECSTATE WASHDC 4151
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/USDOC WASHDC
RUCNMEM/EU MEMBER STATES COLLECTIVE
RUCNFRG/FRG COLLECTIVE

UNCLAS SECTION 01 OF 02 FRANKFURT 005173

SIPDIS

SIPDIS

DEPARTMENT FOR EUR/AGS
TREASURY FOR LUKAS KOHLER/OFFICE FOR EUROPE AND EURASIA

E.O. 12958: N/A
TAGS: [EFIN](#) [ECON](#) [GM](#)
SUBJECT: Frankfurt Stock Exchange: Meeting Global Capital
Potential?

FRANKFURT 00005173 001.2 OF 002

11. SUMMARY: The Frankfurt Stock Exchange (FSE) is the world's third largest and the sixth by market capitalization. Known for its high-tech trading technology, it has played a lead role in cementing Germany's reputation as a financial and economic power. However in an increasingly securitized world, German companies and investors have kept their distance from the equity market and Germany has low rates of market capitalization and stock ownership for an economy of its size. Not only has Frankfurt failed to keep pace with other more globalized financial centers, but the Germany economy also remains more self-contained and at a distance from global capital.
END SUMMARY.

Germany's Underdeveloped Equity Market

12. Despite having one of the world's largest and most dynamic economies, Germany's overall stock market capitalization remains only 57% of GDP. Compared with ratios of 300% in Switzerland, 150% in the U.S. and 92% in India, a larger part of the German economy still lies outside the stock market. Financial experts have criticized the lack of capitalization, saying that capital remains inefficiently allocated and firms lack sources of funding for expansion. In a November 19 speech at the Euro Finance Week conference in Frankfurt, Deutsche Bank CEO Josef Ackermann pointed out this weakness in the German economy, saying that "a high market capitalization is a central factor in the quality of a financial center and a national economy."

13. Low-level market capitalization in Germany is primarily a result of the business model of the "Mittelstand," Germany's small and medium-sized enterprises (SMEs). Loans from German banks are still the most important debt instrument for SMEs, which make up 99% of Germany's 3.3 million companies and provide 70% of its jobs. German banks and SMEs have had a historically close, relationship-based lending system. Most loans from regional banks (Landesbanken) enjoyed state backing as recently as 2005. Germany's state development bank, Kreditbank fuer Wiederaufbau (KfW), lends and provides advice to SMEs and made 15.8 billion euros in commitments in 2007.

14. German SMEs have shown a hesitancy to go public in recent years. In 2006, around 3 billion euros were raised in initial public offerings (IPOs) in Germany, compared with 17 billion euros in Great Britain and 30 billion euros in the U.S. A November 2007 German Stock Institute survey revealed that only 24% of German SMEs were considering an IPO in the future. A full 60% of the firms surveyed said other forms of financing sufficed, and 30% feared that going

public would bring costly regulatory burdens that they cannot afford. Shareholder rights are also strong in Germany meaning that once a company goes public it must maintain high, and often costly, transparency requirements.

¶15. Staying private means SMEs face greater challenges in strengthening their equity ratio and improving their credit standing in the eyes of global investors. Ackermann argued in his speech that "they (equity markets) are indispensable for efficient capital allocation and cost-effective enterprise financing." In relying on German bank loans, SMEs remain a step removed for global investment.

Why Germans Don't Own Stock

¶16. Germany also lags behind other large economies in stock ownership with only 7% of Germans directly invested in stocks as compared with over 20% in Great Britain, the U.S. and Switzerland. German pension funds are also less invested in stocks as their foreign equivalents and only 15% of Germans participate in private pension plans. A Deutsche Bank researcher told Econ Specialist November 29 that while Germans had a high savings rate of around 11%, the state covers large expenses such as higher education and retirement, meaning that potential investors do not see the need to "grow money quickly," unlike in other countries.

¶17. Starting in 2009, private German shareholders will pay a capital gains tax of 50% when they own less than 1% of a company, a move which is unlikely to foster a shareholding culture in Germany. Such a tax already applies for private shareholders who own more than 1%, while corporate capital gains are taxed at 25%. Both the burst of the dot-com bubble in 2000-2001 and a similar bust in over-valued shares of Deutsche Telekom in 2002 have only cemented the popular view in Germany that stocks are a risky venture.

Deutsche Boerse: A Regional Player

FRANKFURT 00005173 002.2 OF 002

¶18. Deutsche Boerse AG, which manages the Frankfurt Stock Exchange, has attempted to remain competitive with mixed results. In 1999, Deutsche Boerse unveiled the Neuer Markt (New Market), a small exchange for start-up and high-tech companies that followed the model of the NASDAQ. Despite initial success, the Neuer Markt closed in 2003, a victim of the global dot-com bust. The Deutsche Boerse also failed in its bid to expand by taking over the London Stock Exchange in 2004, when its shareholders failed to back the move.

¶19. A notable success for Deutsche Boerse was the launching of the high-tech Xetra electronic trading system in 1997, which opened the market to more European investors. Deutsche Boerse introduced the Entry Standard in October 2005, whereby smaller companies can list themselves while meeting fewer formal requirements. The FSE has cemented itself as a leading exchange market for the Euro zone, but clearly does not compete with counterparts such as London, which liberalized its equity market as early as the 1980s and took on a global role. A senior AmCham representative told Econ Off November 1 that Deutsche Boerse retained a focus on the German and European economies but "faces a real challenge in that it wants to grow, but can find no partners."

¶10. COMMENT: The German economy looks to remain the outlier among the world's large economies in market capitalization and stock market participation. During the current period of economic upswing in Germany and global financial unrest, there is little public debate about the need to change traditional financing practices. While the FSE is certainly not in decline, it remains a regional player, leaving global capital investment to other centers. END COMMENT.

¶11. This cable was coordinated with Embassy Berlin.

POWELL